

ECONOMIC ANALYSIS OF SALES TAX REFORM PROPOSAL

**Hank Fishkind, Ph.D.
Fishkind & Associates, Inc.
407-382-3256
Fishkind.Com
January 24, 2001**

Introduction

- **January 8, 2002 presentation**
 - **Analysis of the need for tax reform**
 - **Impact analysis based on projected exemptions**
- **Today's presentation**
 - **Economic analysis of program based on list of proposed exemptions**
 - **Rate reduction from 6% to 4.5%**

Analysis of the Economic Impacts of Proposed Program Best Viewed in Context of Options Florida Faces

- (1) Continue Raising the Sales Tax Rate**
- (2) Reduce Expenditures**
- (3) Impose New Taxes**
- (4) Broaden the Tax Base**

Criteria Used to Select Exemptions -- Senator Pruitt

- **Protect households**
 - exempt food, medicine, healthcare, rent, and residential utilities
- **Protect 1st Amendment, religious, educational, charitable and non profits**
- **Promote economic development**
 - preserve exemptions for manufacturing, R&D,
 - Minimize tax pyramiding
- **Tax personal, professional services and some business services**
- **Ensure tourists pay their fair share**

Arithmetic of the Proposal

(in \$000s)

FY 2002-03 Sales Tax			\$16,691
Savings/Loss from Rate Reduction	(6% to 4.5% = -25%)		(\$4,173)
Add-Back for Transient Rentals @ 6%	<div> <div></div> <div>Taxes on tourists</div> </div>		149
Add-Back for Admissions @ 6%			91
Add-Back for Rental Cars @ 6%			46
Deduct for Electricity From 7% to 4.5%			(40)
Repeal Health Care Assessment			(244)
		=====	
Total Savings/ Revenue to Be Replaced			(\$4,170)
Base broadening measures			\$4,270

Distribution of Sales Tax Exemptions Before and After Tax Reform in \$Billions

Categories	Before @ 6%	After @ 4.50%
Total to Households	\$6.2	\$3.6
Total to Business Organizations/other	\$14.9	\$8.0
	\$1.8	\$1.4
	=====	=====
	\$23.0	\$13.0

Governor Bush's Concerns

“ As Governor, I want to facilitate full, honest and transparent dialog on this issue. As the debate has begun, answers to some common-sense questions should determine the direction we take on this issue. How will this plan affect the competitiveness of Florida's businesses, especially the small businesses that are driving our economy? How will the debate over the next two years impact our investment climate? What of tax equity and fairness? Will Floridians have to pay more and our tourists less? What about compliance?”

How will this plan affect the competitiveness of Florida's businesses, especially the small businesses that are driving our economy?

- **Carefully crafted to protect Florida's competitive position**
 - **Businesses subject to interstate and international competition exempted**
 - **Examples: manufacturing, R&D, Agriculture, satellites/space vehicles**
- **Tax on services NOT a tax on Florida's service providers**
 - **Tax on sale or use of service IN Florida**

Impact on Businesses Depends on a Variety of Factors

- **Many businesses will have a TAX CUT enhancing their competitive position!**
 - **retailers, auto dealers, restaurants**
- **Can the business pass along the tax?**
 - **YES in majority of cases**
 - **Customary practice in most situations**
 - **Price elasticity of demand -- does demand go down when price goes up?**
 - **Sometimes yes and sometimes no**

Florida's Small Business

- **Most small businesses will benefit**
 - **Demand for personal and professional services relatively price inelastic over range of 4.5%**
 - **Manufacturing exempt**
 - **Retailers & restaurants benefit**
- **Most Florida small businesses spend more on rent, utilities, and supplies than on professional services**

Typical Small Business

A small business with \$500,000 in expenses that spends:

- 35% on rent, utilities, and supplies
- 10% on professional services

Will save \$375 a year in taxes

Typical Small Business

Small Business total expenses	\$500,000
Total expenses	\$500,000
Rent, utilities, supplies @35%	\$175,000
Professional services @10%	\$50,000
Reduction in costs 6% to 4.5% rent, utilities, supplies	\$2,625
Increase in costs @4.5% on professional services	\$2,250
Savings from tax reform	\$375

Impact on Personal, Professional and Business Services

- **Many are small**
- **Demand relatively price inelastic
allowing pass through of tax**
- **Level playing field for all**
 - **Tax is on sale/use of service whether
provided by a Florida firm or not**

Impact on Transportation Services

- **Tax is imposed on the sale and use of transportation services in Florida**
- **Not a tax on Florida transportation providers**
- **Level playing field**
- **Price elasticity very low allowing tax to be passed through**
- **Creates some tax pyramiding**

Impact on Entertainment, Sports, Financial Services

- **Entertainment and sports typically include tax on tickets -- little or no impact likely**
- **Tax on other bank services**
 - **Relatively price inelastic**
 - **Tax will be passed along for the most part**

Impact on Construction Services

- **1.5% tax imposed**
- **Offset by the reduction in the tax on construction materials**
- **Essentially no net impact**

Businesses Most Impacted that Likely Cannot Pass Tax Along in Prices

- **Broadcasters affected by tax on TV distribution, syndication and broadcast rights**
- **Water borne transportation services due to interstate competition**

**Must compare these negative impacts
to benefits achieved by program**

How will the debate over the next two years impact our investment climate?

- **There will be no debate over the next two years**
- **Definitive list of proposed exemptions was developed for your review to meet this concern**
- **Legislature can change exemptions at anytime regardless of this reform proposal, so no change in “uncertainty”**

What of tax equity and fairness?

- **System will be much more equitable after tax reform than it is today**
- **Today 6%**
 - **Business exemptions =\$15 billion**
 - **Household exemptions = \$6 billion**
- **After tax reform 4.5%**
 - **Business exemptions =\$8 billion**
 - **Household exemptions = \$3.6 billion**

Will Floridians have to pay more and our tourists less?

- **Holding sales tax at 6% on admissions tickets, hotels and rental cars at airports greatly reduces the net benefit to tourists**
- **Reduction in tax rate on restaurant meals and consumer goods benefits residents and tourists**

What about compliance?

- **Department of revenue has become much more automated and efficient**
- **Former DOR Secretary Fuchs concludes that compliance and cost of administration will be reasonable**

Florida's Households

Florida's households could save \$1.4 Billion annually in taxes on their purchases -- some of which will be offset by higher prices

- Households in all income brackets and of all ages will have substantial savings in taxes paid
- Basis
 - Compare household purchases under current system to proposed system with 4.5% rate and broader base
 - Consumer expenditure survey from Bureau of Labor Statistics is the source document

Estimated Tax Savings for Florida Households by Income

Average savings \$227/household

Range from \$146 to \$509 per household

	\$15,000 to \$19,999	\$20,000 to \$29,999	\$30,000 to \$39,999	\$40,000 to \$49,999	\$50,000 to \$69,999	\$70,000 and over
System						
6.0%	\$666	\$865	\$1,058	\$1,298	\$1,487	\$2,264
4.5%	\$520	\$667	\$811	\$989	\$1,146	\$1,756
	=====	=====	=====	=====	=====	=====
	\$146	\$197	\$247	\$308	\$341	\$509

Estimated Tax Savings for Florida Households by Age Group

	All consumer units	Under 25.0	25-34	35-44	45-54	55-64	65-74
Income before taxes	\$44,649	\$19,744	\$45,498	\$56,500	\$58,889	\$48,108	\$29,349
Sales tax @6%	\$1,071	\$706	\$1,137	\$1,280	\$1,303	\$1,137	\$825
Sales tax @4.5%	\$887	\$552	\$930	\$1,058	\$1,064	\$939	\$706
Difference	\$185	\$154	\$207	\$223	\$239	\$198	\$118

Tax Savings Partially Offset by Higher Prices

- **Tax savings are static and assume no change in prices**
- **Most sales taxes incurred by business will be passed along ultimately to consumers in pricing**
- **But pass through is likely to be much less than 100%**
 - **Businesses can deduct sales taxes**
 - **Non Floridians purchase Florida products and services**

How does the Reform Program Compare to Other States?

- **Florida's tax rate would drop to 15th in U.S. from about 40th**
- **Program continues to exempt food**
 - **20 other states tax food**
- **Program taxes personal services**
 - **most states tax some personal services**
- **Program taxes many business services**
 - **most states tax some business services including data processing**

How does the Reform Program Compare to Other States?

- **Program taxes construction services**
 - 11 other states tax this category
- **Program taxes professional services**
 - only 5 other states tax these services
- **Program taxes transportation services**
 - 11 other states tax transportation services for people
 - Florida would be the only state to tax transportation services for goods

Economic Arguments Against Tax Reform

- **No need to reform**
 - **Tax collections keeping up with growth**
 - **Rising expenditures are the problem**
- **Proposed reforms hurt Florida's economy and competitiveness**
- **Bad time to reform**
 - **Recession**
- **Reform creates uncertainty that stifles economic development**
- **Reducing tax rate benefits tourists**

Summary

The proposal to reform Florida's tax system would:

- Reduce the sales/use tax from 6% to 4.5%
- Broaden the tax base
- Implement tax reform without tax increases
- Require 3/5ths vote to increase rate or to add exemptions
- More equitable treatment for Florida's households
- Minimizes impact on Florida's economy